REBUTTAL TESTIMONY
OF
JULIUS A. WRIGHT
ON BEHALF OF
SOUTH CAROLINA ELECTRIC & GAS COMPANY
DOCKET NO. 2002-223-E

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME.

A. Julius A. Wright.

Q. HAVE YOU PREVIOUSLY FILED DIRECT TESTIMONY IN THIS CASE?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I am rebutting a portion of the direct testimony filed by Mr. Donald Coates on behalf of the Department of the Navy, Mr. Nicholas Phillips, Jr. on behalf of South Carolina Energy Users Committee, Mr. Glenn Watkins on behalf of the South Carolina Consumer Advocate, and Dr. Dennis Goins on behalf of SMI Steel – South Carolina. The specific issues I address include the following:

1. Support for the recovery of GridSouth expenses in this rate case;
2. Support for recovery of costs related to two critical

franchise agreements that the Company has entered into with the Cities of Charleston and Columbia; and

3. Support for the Company's position with regard to the pricing of its interruptible tariff.

COMMENTS RELATED TO THE RECOVERY OF GRIDSOUTH COSTS

Q. ARE THE GRIDSOUTH EXPENSES REASONABLE AND PROPER RETAIL ELECTRIC SERVICE EXPENSES?

A. Yes. The GridSouth expenses are reasonable and proper retail electric service expenses. There is simply no question that the GridSouth partners (SCE&G, Duke and CP&L) have been faced with a difficult dilemma as the FERC has pushed for deregulation of the electric industry. On one hand, several areas of the country and many larger customers have been in favor of these changes. However, for the most part, utilities and State Commissions in the Southeast and Northwest have not been in favor of the FERC sponsored changes. Nevertheless, the FERC has been dogmatic in its pursuit of Regional Transmission Organizations ("RTOs") like GridSouth, and more recently, Independent Transmission Providers ("ITPs") as described in their latest Notice of Proposed Rulemaking on Standard Market Design).

In response to these FERC Orders, transmission owning utilities, like the GridSouth partners, were required to participate in an RTO or provide reasons why they could not. In addition, FERC had clearly signaled that companies not joining an RTO would be subject to substantial penalties, including the possible loss of their ability to sell power at market rates in the wholesale markets. Moreover, the GridSouth partners were faced with the unenviable choice of either developing a South Carolina and North Carolina based RTO, or facing the probability of being subject to the jurisdiction and rules of other RTOs that were being developed in other states. For example, at the same time GridSouth was being developed, RTOs were being organized in Florida (GridFlorida), in the states served by the Southern Company System (which became SETrans), and in Louisiana, Arkansas, and Mississippi (through Entergy and others). From my perspective, the decision to pursue a South Carolina/North Carolina RTO was proper, based on the then-current circumstances, in that it would help preserve the control and oversight of this RTO, to the extent possible, within this region and with the South and North Carolina Commissions.

Q: **ON WHAT BASIS DID THE COMPANY ENTER THE GRIDSOUTH PROJECT?**

A. The Company's decision to enter the GridSouth Project was made in the spring of 2000 based principally on FERC's Order 2000. In that order, FERC required all FERC jurisdictional transmission owners to either join an RTO that would be functional by December 15, 2001 or explain why they had not. FERC signaled in that Order that companies that did not join such an organization would be subject to enforcement actions, including possible loss of their ability to participate in market based wholesale transactions.

At the time of Order 2000, FERC was clearly committed to the formation of RTOs. FERC's approach at that time allowed for variation in the structure and function of RTOs to meet local concerns and interests. Under that approach, as reflected in Order 2000, FERC established minimum criteria for RTOs as to independence, scope, operational authority, and short-term reliability, but allowed diversity in the forms, structure, and governance of RTOs within those criteria.

Q: MR. WATKINS IMPLIES THAT THE COMPANY'S DECISION TO DEVELOP GRIDSOUTH WAS NOT IN COMPLIANCE WITH FERC ORDERS AS THE COMPANY HAS INDICATED. PLEASE RESPOND TO HIS ASSERTIONS IN THIS MATTER.

A. The best way to respond to his assertions is to recount the basic history of the various GridSouth filings and related FERC Orders. On October 16, 2000, the GridSouth Companies made their Order 2000 compliance filing with the FERC with regard to the structure and operations of GridSouth. Shortly after that, on November 3, 2000, the participating companies filed with the FERC for a declaratory Order seeking approval of their accounting treatment related to GridSouth costs. The FERC responded first to this declaratory Order request in Carolina Power and Light Co. et al. 94 FERC¶ 61,080 on January 25, 2001. In that order, the Commission granted the three GridSouth utilities an accounting order approving their request to treat ongoing investment in GridSouth as deferred debits and to accumulate carrying costs on these amounts. As that order stated in regards to the earlier compliance filing by the GridSouth companies: "The [compliance] filing included an open access transmission tariff and various agreements that the transmission owners represented would create a for-profit Transco that meets the minimum requirements for an RTO as specified in Order No. 2000." Consequently, this Declaratory Order, early on, signaled to the GridSouth companies that their proposed response to Order 2000 was an acceptable approach.

On March 14, 2001, in response to the GridSouth Order 2000 compliance filing, the FERC granted the GridSouth utilities provisional approval for formation of the GridSouth RTO. This approval was granted in the order entitled Carolina Power and Light Company et al., 94 FERC ¶ 61,273 (the "March 14, 2001 Order").

Some of the items specifically approved in that March 14, 2001 Order were as follows:

- FERC approved GridSouth as an RTO that would operate in only two states, though it encouraged GridSouth to broaden its geographic scope:
- FERC approved GridSouth as a for-profit RTO that could eventually own the transmission assets it operates;
- FERC approved organizational documents under which the GridSouth utilities would manage the formation of GridSouth with certain revisions related to the selection and approval of the Board (note that the organizational documents indicated that the board would be seated when GridSouth became operational).

While this March 14, 2001 Order granted "provisional authority" to implement GridSouth RTO, the provisional aspect of the order did not affect the matters listed above. Instead, the provisional language of the Order reflected only the fact that FERC was requiring that the original GridSouth documents be refiled with limited changes to reflect matters decided in the Order. Therefore, contrary to Mr. Watkins' implications, the FERC response to the GridSouth application was by and large accepted by the FERC as being compliant with its initial RTO directives. Furthermore, the FERC encouraged the GridSouth partners to meet with Santee Cooper and other Southeastern utilities in an effort to expand the geographic scope of GridSouth and to report back to FERC. The GridSouth partners complied with this directive. However, when the FERC chairmanship changed, the FERC's overall approach relating to RTOs was altered.

Q: HOW DID FERC'S POLICIES ON RTOS CHANGE?

A. During the summer of 2001, there was a leadership change at FERC and what I would characterize as a more aggressive FERC policy toward RTOs emerged. For example, on July 12, 2001, FERC issued two orders. The first, Regional Transmission Organizations, Order Initiating Mediation, 96 FERC ¶ 61,066 (2001), opened with the following language:

> *"In separate orders to be issued concurrently with this order, the Commission concludes that it is necessary that the Southeastern transmission owners combine to form one Regional Transmission Organization (RTO). In this order, the Commission initiates mediation for the purpose of facilitating the formation of a single RTO for the Southeastern United States."*

In issuing this order, FERC signaled that a) a two-state Southeastern RTO was no longer acceptable, and b) that FERC's earlier decisions approving the structure and governance of GridSouth were now subject to reversal in the mediation process by which a single Southeastern RTO would be formed. As an indication that the FERC's policies towards RTOs had changed, a quote from Commissioner Massey's concurring opinion in that

July 12, 2001 Order is revealing:

> *"Today marks a watershed in the evolution of our RTO policy. For the first time we set a clear objective for RTO topography, meaning geographic scope, and indicate a fresh resolve to get the RTO job done…..the Commission adopts as its firm objective a single RTO for the Northeast, one for the Southeast, one for the Midwest, and one for the West…..With this clear objective, we at long last provide much needed guidance to the industry…..This guidance is long overdue…But better late than never."*

There is simply no question in FERC Commissioner Massey's mind, and in the minds of most knowledgeable industry observers, that the FERC's RTO policy had changed with this Order.

In the second Order issued on the same day (July 12, 2001, <u>Carolina Power and Light Co. et al</u>, 96 FERC ¶ 61,067) FERC reiterated that it would not permit an RTO of less than regional scope.

The FERC also went further and reversed several specific approvals granted in the March 14, 2001 Order:

- FERC reversed its earlier approval of the organizational documents under which the GridSouth Board would be seated only when the GridSouth RTO became operational. Instead, FERC required the GridSouth Board to be seated within 90 days and all decisions going forward to be made by that Board.
- FERC reversed its earlier approval of the plan under which

the GridSouth utilities would choose the initial officers and managers of GridSouth.

- FERC ordered one officer, already chosen pursuant to the earlier documents approved by FERC, to be removed from office.

In her dissenting opinion to that Order, Commissioner Breathitt stated the following:

> *"Today's order represents a dramatic departure from the approach we pursued in Order No. 2000 to the extent that it directs the formation of four specific RTOs. Just as some commenters to our RTO rulemaking feared, the Magic Markers have come out, and the boundaries are being drawn with little regard to the status and timing of RTO formation efforts in various regions of the country. This was not my intent at the time we issued Order No. 2000; and the events since we issued Order No. 2000 do not compel me to embrace this policy shift. Parties have spent many hours and countless resources in negotiations, collaborations, and complicated business strategy sessions to develop reasonable RTO approaches. The impact of the majority's directive that these four RTOs be formed could be to render these efforts useless and force parties to begin the difficult and time-consuming process anew."*

In this second FERC Order issued on July 12, 2001, Commissioner Breathitt clearly indicates that the FERC's policy towards RTOs had changed. Given this change in FERC policy, along with the impending issuance of a Standard Market Design, the GridSouth partners were prudent in reevaluating the wisdom of proceeding with their initial RTO plans.

Q. WOULD YOU AGREE WITH MR. WATKINS THAT PURSUING THE

GRIDSOUTH RTO CONCEPT WAS FLAWED BECAUSE THE FERC HAD INDICATED A PREFERENCE FOR A SINGLE SOUTHEASTERN RTO?

A. I strongly disagree with Mr. Watkins simply because his comments do not reflect the circumstances at the time. While I admit the FERC encouraged a single Southeastern RTO, the simple fact is that there were a number of RTOs throughout the country that reflected a less than fully regional scope (PJM, New England, Midwest, Alliance, GridFlorida, SETrans, Entergy, SPP). In fact, even today there is no consensus within the industry supporting just four large regional RTOs. More importantly, FERC, in fact, approved the geographic configuration of GridSouth before it changed regulatory direction in the Summer of 2001.

Q: IN YOUR OPINION, WAS THE DECISION TO ENTER THE GRIDSOUTH PROJECT REASONABLE AND PRUDENT?

A. In my opinion, the decision to enter the Gridsouth project was reasonable and prudent. GridSouth represented a unique opportunity to create a locally based RTO answerable to the customers and regulators of South and North Carolina. At the time the decision to enter the project was made, all indications were that GridSouth complied with the FERC's RTO requirements at the time.

Q. DO YOU AGREE WITH MR. COATES THAT THE EXPENSES FOR

GRIDSOUTH SHOULD NOT BE RECOVERED IN THIS CASE?

A. No. Mr. Coates indicated in his direct testimony that the GridSouth project does not represent the sort of extraordinary expense that is properly captured as a deferred expense for future recovery. This is not the case.

The FERC has specifically allowed the deferral of GridSouth costs for future recovery in its accounting order for GridSouth, Carolina Power and Light Co. et al. 94 FERC¶ 61,080 on January 25, 2001. The logic of that decision is clear. Given the fact that the GridSouth expenses were one time start-up expenses for a new organization, incurred in response to new, sweeping edicts from the FERC, I believe that they are properly deferred for future recovery.

Q. DO YOU AGREE WITH MR. PHILLIPS THAT THESE EXPENSES SHOULD NOT BE RECOVERED BECAUSE THEY ARE NOT USED AND USEFUL IN PROVIDING ELECTRIC SERVICE?

A. No. These expenses were incurred specifically in response to regulatory Orders and directives, and they were incurred in the development of a system to support a more open electric generation marketplace. Regulated utilities must respond to and remain in compliance with the directives of the regulators with jurisdiction over them. Costs incurred to do so are a necessary part of utility operations and are used and useful in providing electric service.

Q. CAN YOU GIVE SOME EXAMPLES OF THE TYPES OF EXPENDITURES ELECTRIC UTILITIES MUST UNDERTAKE IN RESPONSE TO REGULATORY DIRECTIVES THAT SOME MAY CONSIDER AS NOT DIRECTLY RELATED TO THE ACTUAL PROVISION OF ELECTRIC SERVICE?

A. Yes. Many aspects of the Company's business are regulated by the South Carolina Public Service Commission and by other regulatory bodies, including FERC, EPA, the Nuclear Regulatory Commission ("NRC"), and the Securities and Exchange Commission ("SEC"). The Company routinely incurs costs in responding to regulatory directives from federal regulators, such as hydro relicensing requirements imposed under the Federal Water Power Act, nuclear operating requirements imposed on the V.C. Summer Nuclear Plant based on new or revised directives from the NRC, and accounting and other directives imposed on it by the SEC. These and other costs incurred to meet the valid directives of Federal regulators are valid expenses related to the provision of electric service, just as are costs imposed by the South Carolina Department of Health and Environmental Control ("DHEC"). As such, these costs are a necessary element in the overall costs related to the provision of electric service.

Q. DO YOU AGREE WITH SOME INTERVENORS THAT THESE

EXPENSES SHOULD NOT BE RECOVERED BECAUSE THEY ARE EXPENSES PRIMARILY RELATED TO THE WHOLESALE MARKET AND THEREFORE SHOULD NOT BE RECOVERED FROM RETAIL RATEPAYERS?

A. No. GridSouth was designed and intended to manage transmission assets and functions for both retail and wholesale customers. As designed, GridSouth would manage the scheduling of generation and transmission resources, transmission planning for the integrated grid, and critical real-time grid security functions to benefit both retail load serving entities, like SCE&G, as well as wholesale customers. Furthermore, the operations of the transmission grid and the transmission tariffs under RTOs would involve the provision of various services, including ancillary services, that would be for the benefit of all customers, wholesale and retail.

The investment in the transmission related functions that GridSouth represents has been treated by the Company in precisely the same way it has treated other transmission related investments made to serve its system. The GridSouth costs have been allocated to retail and wholesale service in proportion to the use of transmission assets by each of the two classes of service. This allocation is in keeping with standard and well-accepted regulatory practice. Given these facts, it is reasonable to recover the costs for GridSouth from all ratepayers as the Company proposes.

Q. DO YOU AGREE WITH MR. WATKINS' REPRESENTATION THAT GRIDSOUTH EXPENSES SHOULD BE DEFERRED AT THIS TIME?

A. No. The Company has incurred these expenses and, as I have already discussed, deserves the recovery of these costs. Moreover, Mr. Watkins' contention that the Company failed to provide information is without merit. I am informed that the Company provided all the information requested once appropriate confidentiality arrangements were made with the other GridSouth partners. In addition, by my count Mr. Watkins' client filed nine sets of interrogatories and the Company provided approximately thirty responses to interrogatories specifically related to GridSouth. Moreover, Mr. Watkins' client filed a motion to compel that included references to GridSouth documents. Yet the Commission in its Order related to this motion denied the request concerning GridSouth documents.

The key point is that the Company has provided a great deal of discovery in this matter, and has complied fully with the Commission's discovery orders.

COMMENTS RELATED TO THE RECOVERY OF FRANCHISE AGREEMENT COSTS

Q. DO YOU AGREE WITH MR. PHILLIPS THAT THERE HAS BEEN

NO CONCLUSIVE, QUANTITATIVE EVIDENCE SUPPORTING THE CLAIM THAT THE COSTS ASSOCIATED WITH MAINTAINING THE CHARLESTON AND COLUMBIA FRANCHISES BENEFIT ALL RATEPAYERS?

A. No. Mr. Lorick has testified these franchises represent approximately 17% of the Company's customers. Based on this fact alone, it should be self evident that if the Company were to lose these customers and these franchisees' future customers, the costs to the remaining ratepayers would be likely to increase rather significantly. In addition, there is little doubt that even a casual observer would agree that these two cities are by far the most important in the Company's service territory. Therefore, it is important that the Company maintain these two franchises and the future growth they represent.

Q. DO YOU AGREE WITH MR. PHILLIPS THAT THE COSTS ASSOCIATED WITH MAINTAINING THE CHARLESTON AND COLUMBIA FRANCHISES SHOULD NOT BE RECOVERED BECAUSE THESE COSTS ARE NOT USED AND USEFUL IN THE PROVISION OF ELECTRIC SERVICE?

A. No. The continuation of these franchise agreements essentially allowed the Company to keep 17% of its current customers on the system and allows the Company to expand its system as those cities grow and develop. These customers share in the recovery of the system's fixed costs and, in doing so, help spread these costs over a larger number of customers. These fixed costs are the costs associated with the provision of electric service and include such things as generating units, transmission lines, and the distribution system. Absent these franchise customers and their future customers paying their share of these costs, providing electric service to the Company's remaining customers would likely increase.

COMMENTS RELATED TO THE INTERRUPTIBLE SERVICE TARIFF

Q. HOW ARE INTERRUPTIBLE SERVICE TARIFFS FOR LARGE CUSTOMERS DESIGNED FROM AN ECONOMIC PERSPECTIVE?

A. Generally, tariffs for larger customers reflect a two part charge, one charge for demand (also called capacity) and one charge for energy. The demand charge is related to the actual fixed cost of providing service while the energy charge is related to the variable costs, primarily fuel, of providing service. With an interruptible service, the demand charge is often discounted reflecting the presumption that the interruptible customer, because he is interruptible at the time of the system peak demand, has avoided the need to construct facilities to supply the peak energy demand.

Q. HOW SHOULD AN INTERRUPTIBLE SERVICE TARIFF BE DESIGNED?

A. While there is debate on this issue, the Company's method of providing a demand charge credit based generally on the cost of a peaking unit is reasonable. This methodology is based on the premise that interruptible customers can assist the utility to forego some of the costs of additional peaking capacity. Thus, the basic idea is that the interruptible credit is generally related to the avoided cost of peaking capacity.

Q. DO YOU AGREE WITH DR. GOINS THAT THE COMPANY'S INTERRUPTIBLE CREDIT SHOULD BE INCREASED?

A. No. Dr. Goins bases his recommendation on the fact that the interruptible credit has declined as a percentage of the total interruptible demand charge. Because of this, Dr. Goins suggests that the demand credit should be increased. This reasoning is flawed simply because the interruptible credit is not based on some percentage of the total demand charge. It has instead been based generally on the avoided cost of a peaking unit, valued to reflect the limitations on the customer's interruptibility, the limit on the use of interruptible load as spinning reserve, and the overall judgment of the Company subject to the regulatory oversight of the Commission. Also, given the fact that the cost of these peaking units has been declining over the past few years, it is not unusual that the credit may have declined as a percentage of the interruptible demand charge. In fact, a reduction in the absolute amount of the credit might well be supportable in these circumstances, but the Company in its judgment, has decided not to seek such a reduction.

Q. DO YOU HAVE ANY OTHER COMMENTS REGARDING THIS ISSUE?

A. I would simply point out that the Commission should be aware of the problems the electric industry has faced when other state commissions adopted policies that involved payments based on high avoided costs. Specifically, in the last two decades federal and state policies were adopted that required utilities to purchase power from non-utility owned generation facilities (qualifying facilities) at the utilities' avoided cost. Early on, several states like California and in the Northeast established rather high avoided cost payments. This led to a large number of qualifying facilities being built in their states largely because the avoided cost payments were actually above the true market value of this electricity. This is one of the reasons that California and states in the Northeast have generally had the highest electric rates in the nation. (Note that states in the Southeast did not adopt avoided cost rates as high as did California and the Northeast). In fact, in New York state I was a party to litigation where the avoided cost contract price being paid by a utility to two qualifying facilities, over the fifteen year term of the purchase power contract, exceeded the market value of the energy by some $1.8 billion dollars.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.